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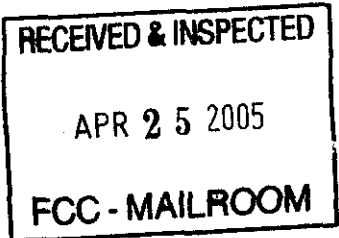
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EX PARTE

April 15, 2005

The Honorable Kevin J. Martin
Chairman
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

Dear Chairman Martin:

The Telecommunications Act of 1996 directed the FCC to establish a universal service support mechanism that would be specific, sufficient, and predictable and that would ensure all Americans have access to affordable telephone service and that, among other principles, shall assure that "consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services ..."¹. The Puerto Rico Telecommunications Regulatory Board (TRB) finds there is an urgent need for such support for Puerto Rico and to that end respectfully encourages the FCC to take the actions it deems necessary to implement this Congressional mandate. The Act requires the FCC to enact a support mechanism that takes into account the special characteristics of insular areas. The current system needs to be amended to take into account such characteristics which are different from those of other non-insular U.S. areas and which system results in inequities that aggravate the problem and need of support in Puerto Rico. As it stands now, the nation's universal service commitment is not being met in Puerto Rico. Although we wrote in May of 2003 to request FCC's attention to the unique problems of insular areas, the problem still exists and, was aggravated by the fact that Puerto Rico's high-cost loop support has been completely eliminated.

The government and people of Puerto Rico need the FCC's help to meet, on a non-discriminatory basis, the economic, educational, and technological standards designed for the mainland United States. At the very least, Puerto Ricans today need access to basic and advanced telecommunications services, which the FCC has noted are "a fundamental necessity in modern society."² Today, even this basic level of service is not fully available.

¹ 47 USC Sec. 254 (b)(3)

² Federal State Joint Board on Universal Service; Promoting Deployment and Subscribership in Unserved and Underserved Areas, Including Tribal and Insular Areas, Twelfth Report and Order, Memorandum Opinion and Order, and Further Notice of Proposed Rulemaking, 15 FCC Rcd 12208, ¶ 3 (2000) ("Tribal Lands Order").

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The wireline telephone penetration rate in Puerto Rico is much lower than that in the mainland United States. The overall Puerto Rico penetration rate is 66.9 percent, compared to 94 percent on the mainland. Various Municipalities have penetration rates lower than 50 percent. In fact, some communities have *no* existing telephone infrastructure at all. Federal funding is critical to move the current penetration level upward. Over the last 30 years, penetration rates on the island have risen from 25 up to 76 percent, which was the highest level achieved in 1997, to where we stand today at 66.9 percent. This rapid rise was a result of the combined effort of the FCC's high-cost program, the TRB, and the incumbent carrier Puerto Rico Telephone (PRT). However, recent FCC rule modifications that zero out Puerto Rico's high-cost support have combined with other complications to stop this growth in penetration rates.

Puerto Rico's unique conditions need federal aid: Puerto Rico poses significant and distinctive challenges for the telecommunications industry and regulators because of its geographic and demographic characteristics. Since Puerto Rico is an island, virtually all of the supplies and materials necessary to build a telecommunications infrastructure must be shipped, adding further costs and taxes to the cost of equipment, tools, and parts and labor. The island's tropical climate—especially the corrosive sea air, high humidity and sometimes violent tropical weather—significantly inflates maintenance costs. Indeed, recently Hurricane Jeanne caused \$5 million in damage to PRT's facilities alone. Further, the island's widely distributed population, rough topography, and limited basic infrastructure make network build-out a costly and time-consuming exercise. The construction of a single loop in Puerto Rico's remote and isolated communities can often cost more than \$15,000. Overall, only Wyoming and the U.S. Virgin Islands have more expensive per-loop costs.

The economic realities of Puerto Rico also create challenges for telecommunications companies like the incumbent carrier, as well as the growing number of competitive carriers attempting to serve the island. Residents of Puerto Rico have a significantly lower per capita income than any mainland State, a fact that is exacerbated by the high cost of living. By one estimate, an individual making the average per capita income in Tupelo, Mississippi (\$15,853), would have to make more than 160 percent of their current income (\$25,882) in order to maintain their standard of living in Puerto Rico. Yet the average income in Puerto Rico dips below \$9,000. The lack of disposable income places significant pressure on carriers and regulators to maintain rates, because any increase in rates or charges risks triggering additional drops in the subscribership level. As such, carriers cannot improve their networks through rate increases, and the TRB is limited in its ability to create a more robust intra-island universal service support mechanism, beyond the successful Lifeline and other supports provided today.

Almost nine years have elapsed after the enactment of the new Telecommunications Act and a specific ruling for direct federal insular aid is still pending. Congress made clear in the Telecommunications Act of 1996 that "rural, *insular*, and high cost areas" warranted special consideration. 47 USC § 254(b)(3) (emphasis added). In implementing the Act, the FCC has adopted new rules which diminish and almost eliminated the much needed high-cost universal service funding for Puerto Rico's eligible telecommunications carriers (ETCs).

Nevertheless, Puerto Rico remains one of the areas most deserving and needing of federal universal service aid.

The FCC has still pending its decision on universal support targeted to insular areas, despite repeated pronouncements that it would take action on this issue. This is specially disconcerting given the Commission's own recognition that insular areas "may face unique problems that could limit their ability to participate in and benefit from all the universal service programs." *Federal State Joint Board on Universal Service; Promoting Deployment and Subscribership in Unserved and Underserved Areas, Including Tribal and Insular Areas*, Further Notice of Proposed Rulemaking, 14 FCC Rcd 21177, ¶ 135 (1999) ("*Unserved NPRM*"); see also *Tribal Lands Order*, ¶ 11. Although the Commission initiated a rulemaking in 1999 to look at the unique needs of insular areas, the Commission has not act yet on that issue. See *Unserved NPRM* at ¶ 56-63. In the meantime, the Commission has already acted to assist similarly situated areas, most notably tribal lands, which were singled out as areas especially in need of aid because of their low penetration rates and per capita income. See *Tribal Lands Order* at ¶ 5. Puerto Rico equal treatment, as mandated by Congress in the Telecommunications Act of 1996, is still pending.

The Commission's pending action to adopt an insular mechanism uniquely affects Puerto Rico because all the carriers that serve other insular areas also qualify as rural areas eligible for funding under the FCC's rural universal service mechanism. Due to the size of the San Juan area, Puerto Rico does not qualify as "rural" under the FCC's current high-cost programs. Puerto Rico also fails to qualify for funds under the FCC's recently modified non-rural support mechanism, because the forward-looking cost model forces Puerto Rico into the same category as New York City and other metropolitan areas in the mainland United States. It is evident that models based on mainland assumptions do not translate when applied to insular areas, because their emphasis on line density, population density and economies of scale are inapplicable.

Thus, today Puerto Rico receives \$0 in high-cost loop support despite its disproportionately low telephone penetration rate and obviously higher infrastructure and maintenance costs inherent in its being a tropical island. This result is illogical and unreasonably disadvantages the people of Puerto Rico. To remedy this inequity, we support PRT's efforts³ to adopt a non-rural insular mechanism based on carriers' actual costs, which is consistent with

³ Ex Parte, CC Docket No. 96-45, 11/4/2004 - In a letter to Jeffery Carlisle, Chief of the Wireline Competition Bureau, Nancy J. Victory, Counsel for Puerto Rico Telephone Company, wrote to respond to a request for additional information regarding the difficulties of providing telephone service in Puerto Rico. PRTC stated that restoration of high-cost universal service funding to Puerto Rico, such as through an insular mechanism, is crucial to maintaining existing service levels and necessary to ensure that all Puerto Ricans have access to basic phone service at rates comparable to their fellow Americans on the mainland.

Congress' intent that insular areas receive solutions tailored to their unique needs, and ensures that Puerto Rico receives support in the same manner as every other high-cost insular area. Under this plan, which has proven to be effective in rural areas, Puerto Rico's ETCs will receive approximately \$3.00 per line in monthly support, returning high-cost support to a level which will allow for adequate maintenance and appropriate network improvements as well as continued build-out to unserved communities.

Puerto Rico would also welcome targeted funding to low-income consumers in light of low penetration rates on the island. Importantly, such reforms must act as a complement to, not a supplement for, high-cost support. We urge the FCC to act quickly in addressing the situation that Puerto Rico faces and to consider PRT's suggested methodology. We are also confident that you will understand, and will take the necessary actions on the special situation described herein which is affecting Puerto Rico.

The TRB looks forward to working with you as we move closer to the goal of universal service for all citizens in all areas.

Cordially,

A handwritten signature in black ink, appearing to read "Miguel Reyes Dávila". The signature is fluid and cursive, with a large initial "M" and a long, sweeping underline.

Miguel Reyes Dávila, Esq.
President

cc: Hon. Aníbal Acevedo Vilá, Governor of Puerto Rico
Hon. Luis Fortuño, Resident Commissioner for Puerto Rico on U.S. Congress
Hon. Aníbal José Torres, Chief of State Commonwealth of Puerto Rico
Commissioner Kathleen Q. Abernathy
Commissioner Michael J. Copps
Commissioner Jonathan S. Adelstein
TRB Commissioner Vicente Aguirre-Iturrino
TRB Commissioner Jorge L. Bauermeister-Marrero
Mr. Jeffrey Carlisle, Chief of FCC Wireline Competition Bureau



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November 4, 2004

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Jeffrey Carlisle
Chief, Wireline Competition Bureau
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

**Re: Puerto Rico Telephone Company
Request for Insular Universal Service Mechanism
CC Docket No. 96-45**

Dear Mr. Carlisle:

Thank you again for meeting with us last month concerning the state of local telephone service in Puerto Rico and the challenges of serving this high cost, but low income area of our country. This letter responds to your request for additional information regarding the difficulties in providing local telephone service in Puerto Rico as well as how a restoration of high cost universal funding, such as through an insular mechanism, would enable Puerto Rico Telephone Company ("PRT") to expand subscribership and maintain affordable rates despite those challenges.

Puerto Rico Presents a Compelling Case for High Cost Universal Service Funding

As we explained in our meeting, Puerto Rico is an area seriously deserving of high cost universal service funding. The penetration rate for telephone service within the commonwealth currently stands below 70 percent – far below both the national average (94 percent) and even the lowest state penetration rate (88.8 percent in Arkansas). The penetration rate in many of Puerto Rico's rural counties is substantially lower – in some places below 50 percent. Indeed, the mountainous, densely vegetated interior of the island contains numerous communities that are not yet passed by telephone plant or other basic utilities.¹ Attachment A is a map that shows the telephone penetration rates in counties throughout Puerto Rico.

The drastic situation in Puerto Rico stems directly from the higher costs of providing service associated with the terrain, the insular nature of the island, and the

¹ Approximately 98 percent of all occupied dwelling units in Puerto Rico have access to electrical service. However, a number of remote areas lack this basic service.

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area's economic condition. The island's rugged terrain and the lack of good roads in some parts of the island significantly hamper build-out and increase maintenance costs. The costs of providing service on the island are also far greater than on the mainland due to high shipping costs, the corrosive nature of the environment, and unpredictable and sometimes violent weather conditions. The ability of telephone companies in Puerto Rico to raise rates to cover these higher costs is very limited due to the relatively high cost of living in Puerto Rico coupled with the very low average income of the citizens. Puerto Rico's per capita income of less than \$10,000 per year is far lower than any U.S. state and results in over half of the population living below the poverty line.

In recognition of these challenges, Puerto Rico had received as much as \$51.9 million in annual high cost universal service funding. However, as a result of the Commission's revision of its high cost fund methodology in 1999, Puerto Rico now receives \$0.² Despite the obvious cost challenges in Puerto Rico, the cost approximation model for non-rural companies adopted by the agency strangely treats Puerto Rico as having the same cost characteristics as suburban New Jersey. Obviously New Jersey is a much more developed and accessible area that lacks the many cost-pricing challenges facing Puerto Rico.

Restoring High Cost Funding to Puerto Rico Is Essential to Maintaining and Expanding Affordable Telephone Service in Puerto Rico

Restoration of high cost universal service funding to Puerto Rico, such as through an insular mechanism, is essential for companies like PRT to be able to maintain affordable rates and to expand telephone service to new subscribers. From the high-cost program's inception until 1996, PRT was able to increase penetration rates on the island dramatically from as low as 25 percent in the 1970s to just over 70 percent. Over the years there has been a definite correlation between the availability of high cost universal service funding, PRT's capital investments, and an increase in telephone penetration in the commonwealth. Since funding began to be phased-down in 2001, the previously growing penetration rate has stagnated and fallen back slightly and capital investments have been reduced. *See Attachment B.*

² *See Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432 (1999) (Ninth Report and Order)*

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Similar to other companies that currently receive high cost loop support, PRT would use universal service funds for a variety of purposes in order to provide quality, modern, and affordable local telephone service to consumers. These uses include:

- Construction of new network and loop infrastructure to unserved areas and modernization of existing facilities;
- Maintenance of network for voice telephony and to ensure compatibility with broadband services;
- Maintenance of and improvements to quality of service;
- Maintenance of affordable rates; and
- Education and solicitation of potential first-time telephone customers.

Each of these is discussed in more detail below:

Construction of New Plant and System Modernization. Currently, PRT estimates that there are over 200 isolated communities in Puerto Rico without phone service. Many of these are in the interior of the island where the mountainous, jungle terrain and lack of good roads make the construction of new plant both very expensive and challenging. Indeed, a single loop in Puerto Rico can cost up to \$15,000. In addition, investment is needed to upgrade the telephone plant so that Puerto Ricans can enjoy telephone service of the same reliability and quality enjoyed by other Americans. Universal service funding is crucial to enabling PRT to make the investments needed to fund such network expansion and modernization, particularly in rural areas of the island. If high cost loop support is provided under the insular proposal to eligible carriers in Puerto Rico, PRT expects to commit at least 65 percent of such funds to expansion of service to low income and unserved areas, with the remainder used for maintenance and improvement of the network.

Network Maintenance. As noted above, the costs of maintaining a telephone network in Puerto Rico are very high due to the added expense of delivering equipment, tools and parts to the island and the costs of combating the effects of the corrosive and sometimes violent tropical climate. Indeed, the \$5 million in damage PRT's network recently sustained from Hurricane Jeanne is a case in point.³ Minimum maintenance on the system must be done regardless of the availability of universal service funds. However, additional expenditures (around \$26 million) in

³ Unfortunately, none of this is recoverable through insurance due to PRT's \$10 million deductible.

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the area of maintenance of outside plant are needed. The restoration of high cost funding would enable PRT to provide a more expanded and effective maintenance program that would better protect service reliability and prolong the life of the system.

Quality of Service. Puerto Ricans deserve the same quality of service enjoyed by other Americans. The recent termination of high cost universal service funding to Puerto Rico makes maintenance of service quality – not to mention improvements in quality – an uncertain enterprise. The restoration of high cost funding would enable PRT to take steps necessary to ensure that service quality is not only maintained, but improves. If funding commensurate with past levels were restored, PRT envisions investing \$20 million in enhanced service quality initiatives. Among other things, PRT would provide its technicians with better tools and access to improved support systems that will help them in identifying problems. This should speed service provisioning and reduce repair time.

Maintenance of Affordable Rates. Restoration of high cost universal service funding is also essential to maintain telephone rates that the people of Puerto Rico can afford. As noted above, the average annual salary in Puerto Rico is below \$10,000, far lower than any mainland state. As a result, subscribers in Puerto Rico are extremely price elastic – additional costs cannot simply be passed through to subscribers without further threatening Puerto Rico's already low penetration rate. Complicating this further is an ongoing rate rebalancing effort that is underway in Puerto Rico. Within the last year, PRT (with the cooperation and encouragement of the Board of Telecommunications Regulation of Puerto Rico) has reduced the number of local calling zones on the island from 68 to 10 and embarked on a phased-in rebalancing of rates.⁴ Low-income support does not completely address this problem because low-income support is a straight pass-through to the customer and does nothing to help the company maintain and operate the network. This is why high cost loop and low-income support have both been available to qualifying states for many years.

Education and Attraction of New Subscribers. As noted above, the existence of high cost loop support has been instrumental in making great strides in customer penetration rates over the years. In addition to assisting with building new plant and

⁴ Under the old plan, although many rural communities had local rates of \$7 to \$12, consumer phone bills were equal to or greater than those in urban areas with larger calling scopes because of the toll charges incurred by rural consumers.

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keeping rates affordable, a restoration of high cost universal service funding could also enable PRT to fund a program to educate consumers in Puerto Rico about telephone service. As the penetration rates suggest, some residents of Puerto Rico have never had telephone service and do not fully appreciate what it is or why they might benefit from it. If funding were restored, PRT would anticipate launching a house-to-house effort⁵ in some of the areas passed by telephone plant but with low penetration levels to educate residents about telephone service.

In sum, the restoration of high cost universal service funding to Puerto Rico, such as through an insular mechanism, is crucial not only to maintaining existing service levels in Puerto Rico but to ensuring all Puerto Ricans have access to basic telephone service comparable to their fellow Americans on the mainland. Given the extensive service challenges PRT faces and the extremely low telephone penetration rate on the island, Puerto Rico is precisely the type of area that should be receiving high cost funding, not one that should be zeroed out. As detailed above, PRT anticipates putting any restored funding to good use not only to maintain, but to improve and expand telephone service in Puerto Rico.

Please let me know if you have any further questions or require additional information.

Sincerely,

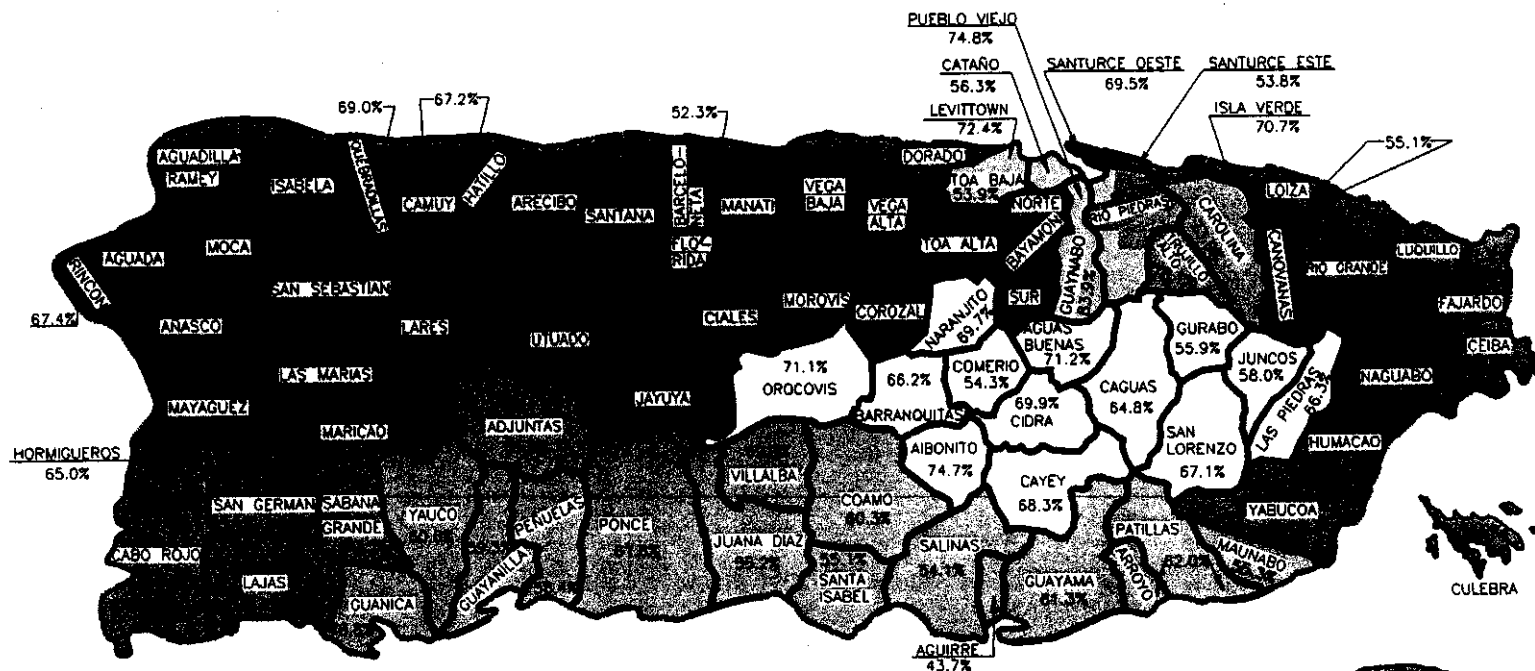
Nancy J. Victory

Nancy J. Victory
Counsel for Puerto Rico Telephone Corp.











cc: Cathy Carpino
Narda Jones
Richard Lerner
Robert Tanner

⁵ In Puerto Rico, outreach to consumers by businesses is typically still done house-to-house.

PERCENTAGE OF HOUSEHOLDS WITH A PRT TELEPHONE LINE,
AS OF DECEMBER 2004



LEGEND

 METRO NORTH	= 61.5%	 ISLA NORTH	= 60.5%
 METRO SOUTH	= 68.3%	 ISLA SOUTH	= 59.5%
 METRO EAST	= 75.6%	 ISLA EAST	= 55.3%
 METRO WEST	= 75.3%	 ISLA WEST	= 62.9%
 METRO CENTRAL	= 75.1%	 ISLA CENTRAL	= 65.6%

TOTAL PRT = 64.8%

Prepared by: Forecast Analyst
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Note: Revised with data up to December 2004.

